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In The
Supreme Court of the United States

IMPRESSION PRODUCTS, INC.,
Petitioner,

v.

LEXMARK INTERNATIONAL, INC.,
Respondent.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

BRIEF OF *AMICUS CURIAE* IMAGING SUPPLIES COALITION IN SUPPORT OF RESPONDENT LEXMARK INTERNATIONAL, INC.

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STATEMENT OF INTEREST OF *AMICUS CURIAE*

Imaging Supplies Coalition submits this brief[1] in support of Lexmark International, Inc. to urge the Court to uphold the rulings of the *en banc* Court of Appeals for the Federal Circuit regarding important issues related to patent exhaustion. The Federal Circuit's opinion below strikes the proper balance between protecting the rights of patentees and limiting those rights through the exhaustion doctrine.

Imaging Supplies Coalition ("ISC") is a nonprofit organization dedicated to protecting the interests of consumers and original equipment manufacturers ("OEMs") of consumable imaging supplies and equipment. The members of the ISC are: Brother International Corporation, Canon U.S.A., Inc., Epson America Inc., Hewlett-Packard Company, Lexmark International, Inc., Samsung Electronics America, Inc. and Xerox Corporation.

Founded in 1994, ISC's mission is to protect its members' customers from misrepresented

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[1] No counsel for a party authored this brief in whole or in part. No party or party's counsel contributed money intended to fund preparing or submitting the brief. Some members of the ISC (but not including Lexmark International, Inc.) made a monetary contribution intended to fund preparation or submission of this brief. No person -- other than *amicus curiae*, some of its members, or its counsel -- made a monetary contribution to its preparation or submission. Respondent's blanket letter of consent to the filing of *amicus* briefs has been filed with this Court. Petitioner's consent dated February 8, 2017 is being submitted herewith.

products and services by seeking the worldwide protection of intellectual property and related assets of stakeholders in the imaging supplies industry. ISC dedicates substantial effort and resources to educate, empower and protect distributors, suppliers and consumers in the battle to eliminate illegal activities in the imaging supplies industry. It accomplishes this mission by training and education, collaboration with law enforcement, public relations activity and supporting the efforts of OEMs and other rights holders to enhance and protect intellectual property rights. In its 23-year history, the ISC has accomplished a great deal in combating infringement and fraud. Its efforts have established the ISC as an international force in the imaging supplies industry as well as a leading organization in intellectual property rights protection.

ISC members invest substantial resources and effort in researching and developing new technology for the imaging supplies industry and protecting this new technology through intellectual property rights. To protect these investments, the ISC and its members must also spend significant resources fighting infringement. Because consumable imaging supplies and equipment are a repeat market with a ready supply of empty consumed units, it is relatively easy for infringers and arbitragers to create an illegal aftermarket in imaging supplies. Consequently, OEMs in the imaging supplies industry must wage a constant battle against unauthorized and infringing activity to protect their valuable intellectual property rights, to maintain the goodwill associated with their brands, and to protect

their consumers from inferior products that trade off the OEMs' well-earned reputations.

Maintaining strong intellectual property rights and supporting enforcement activities of rights owners are crucial to the ISC's mission. OEMs rely upon their patent rights in making many important business decisions, including decisions related to: investments in research and development for new technology; global product availability and pricing; the structure of licensing agreements, including worldwide royalty payments; intellectual property ownership and portfolio management plans; and patent protection and enforcement, including anti-counterfeiting and gray market prevention. Accordingly, stable and uniform precedent regarding patent rights is important to the ISC, to its members and to the U.S. economy. For these reasons, the ISC submits this brief as *amicus curiae* urging this Court to affirm the Federal Circuit's thorough and well-reasoned decision below on important issues defining the doctrine of patent exhaustion.

SUMMARY OF ARGUMENT

The Federal Circuit, supported by its own existing precedent and a long line of decisions from this Court, held that: (1) patent rights are not exhausted by sales made under a valid restricted-use license (*Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992)) and (2) patent exhaustion does not arise from authorized sales made overseas (*Jazz Photo Corp. v. ITC*, 264 F.3d 1094 (Fed. Cir. 2001)). This Court should affirm the decision below and uphold the rules of patent exhaustion set forth by

the Federal Circuit. To do otherwise would be inconsistent with long-standing and stable precedent with respect to the patent exhaustion doctrine. The rules and limits on the patent exhaustion doctrine set forth in the decision below have been relied upon by rights owners in:

(i) developing and investing in innovative new products;

(ii) supporting the availability of products in less-developed countries through price differentiation and market segmentation;

(iii) designing and executing programs against infringement and gray market exploitation;

(iv) structuring and relying upon valid patent license use-restrictions that incentivize innovation and reward research and development; and

(v) developing important policies and programs that enhance consumer choice, quality control and OEM reputation, health and safety, and environmental preservation.

Neither law nor policy supports overturning the reasoning and rulings set forth by the Federal Circuit. ISC supports Lexmark's position that the decision of the Federal Circuit below must be affirmed because: (1) sales made under a lawful and

valid use-restriction do not exhaust patent rights and (2) sales made outside the United States do not give rise to patent exhaustion.

ARGUMENT

I. Existing Law and Public Policy Support the Rule that Patent Exhaustion Does Not Apply to Sales Made Under Lawful and Valid Use Restrictions.

In upholding and reaffirming its decision in *Mallinckrodt*, the Federal Circuit ruled that patent exhaustion does not apply to sales made under a lawful and valid use-restriction. *Lexmark Int'l, Inc. v. Impression Prods., Inc.*, 816 F.3d 721, 773-4 (Fed. Cir. 2016). This Court should affirm the ruling below because a rule of patent exhaustion that permits valid use restrictions is well-grounded in both law and policy. Furthermore, the ruling is not in conflict with this Court's decision in *Quanta Computer, Inc. v. LG Electronics, Inc.* Indeed, respecting patentees' freedom to contract with respect to their patent rights (including the freedom to make conditional sales like those at issue in *Mallinckrodt*) benefits public welfare through wider dissemination of patented technology, greater quality and safety control, and lower prices that give consumers more freedom of choice in making purchasing decisions.

A. Precedent Supports the Federal Circuit's Ruling Below.

This Court has a long history of permitting restricted conditional sales or licenses without triggering exhaustion of patent rights. *See General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175 (1937); *American Cotton-Tie Co. v. Simmons*, 106 U.S. 89 (1882); *Mitchell v. Hawley*, 83 U.S. 544 (1873). Following this long line of precedent, the rule espoused by the Federal Circuit below is clear, well-reasoned and consistent with over a century of related Supreme Court precedent. *See Lexmark*, 816 F.3d at 735-753 (examining and analyzing the long line of cases that support valid use restrictions without exhaustion of rights); Robert W. Gomulkiewicz, *The Federal Circuit's Licensing Law Jurisprudence: Its Nature and Influence*, 84 Wash. L. Rev. 199, 225 (2009) (noting that the *Mallinckrodt* decision cites more than twenty Supreme Court cases and that it would be hard to argue that the Court ignored Supreme Court case law in *Mallinckrodt*).

The rule that valid conditional sales do not exhaust patent rights is consistent with established principles of law and with relevant policy considerations. Importantly, use restrictions do not prevent the purchaser from using the article transferred under license for its intended purpose. John W. Osborne, *Justice Breyer's Bicycle and the Ignored Elephant of Patent Exhaustion: An Avoidable Collision in* Quanta v. LGE, 7 J. Marshall. Rev. Intell. Prop. L. 245, 262 (2008). In addition, valid use restrictions do not unlawfully extend the

scope of the patents at issue. *Id.* (the asserted claim covered the device sold and there was no attempt to expand the scope to cover something not patented). Furthermore, the rule in *Mallinckrodt* does not allow for double dipping and collecting separate royalties for the same article. *Id.* (noting "the royalty received by the patentee in *Mallinckrodt* was bargained for based on a single use of the patented article"). Instead, "common field of use restrictions...have been part of patent licensing for hundreds of years in complete accord with Supreme Court precedent." *Id.* at 283. Consistent with Supreme Court precedent and widespread industry practices, valid use restrictions that are "within the scope of the patent grant or otherwise justified" do not exhaust patent rights. *Mallinckrodt*, 976 F.2d at 709.

B. *Quanta* Did Not Overrule *Mallinckrodt*.

In *Quanta*, the Supreme Court determined that an *unconditional* first sale exhausted patent rights. *Quanta Computer, Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 638 (2008). Specifically, this Court found that "[the license agreement] broadly permits Intel to 'make, use, [or] sell' products free of LGE's patent claims," that "Intel's authority to sell its products embodying the LGE Patents was not conditioned on [notice of restrictions or compliance with such notice]" and that "[n]o conditions limited Intel's authority to sell products substantially embodying the patents." *Id.* at 636-67.

Quanta dealt with an unconditional sale, not a restricted use condition. Accordingly, *Quanta* does

not conflict with the precedent set by *General Talking Pictures* and followed by *Mallinckrodt*. *See* Erin Julia Daida Austin, Note, *Reconciling the Patent Exhaustion and Conditional Sale Doctrines in Light of Quanta Computer v. LG Electronics*, 30 Cardozo L. Rev. 2947, 2974 (2009) ("[g]iven that the unanimous *Quanta* opinion does not overrule *General Talking Pictures* but rather distinguishes it, the conditional sale doctrine should still be viewed as good law"); Gomulkiewicz, *supra*, at 237 (concluding that the Supreme Court in *Quanta* "quietly affirmed *Mallinckrodt* and its progeny").

C. Valid Use Restrictions Reduce Health, Safety and Quality Problems.

The public benefits from valid use restrictions that are put in place to mitigate important health, safety and quality problems. Allowing conditional sales without exhausting patent rights encourages downstream users and purchasers to comply with such restrictions, including in situations that can be, quite literally, life and death. Indeed, as was the case in *Mallinckrodt*, single-use restrictions are often designed to avoid important and potentially life-threatening consequences. *See Mallinckrodt*, 976 F.2d at 702. In particular with medical devices or equipment, unless these articles are limited to a single use, there are risks of infections, disease transmission, material instability, and decreased diagnostic performance. *Id. See* Eucomed Medical Technology, *Eucomed White Paper on the reuse of single use devices*, 6-16, Dec. 15, 2009, http://www.medtecheurope.org/sites/default/files/reso

urce_items/files/15122009_MTE_Eucomed%20White%20Paper%20on%20the%20reuse%20of%20single%20use%20devices_Backgrounder.pdf (discussing the benefits of single-use devices in the medical field and the risks of reprocessing them). The current rule recognizes that single-use restrictions are a valid way of addressing these crucial concerns for public safety by the OEMs, who are in the best position to know the dangers and risks associated with their products.

In all types of industries, use restrictions allow OEMs to protect consumers from potential ill effects associated with the unauthorized reuse of their products. The *Mallinckrodt* scenario illustrates the beneficial health effects of single-use restrictions for medical products. With respect to the members of ISC, used cartridges or imaging supplies that are refilled and/or unlawfully modified to circumvent use-restrictions are more susceptible to malfunctions and poor performance. This could affect the consumer's experience and may result in a consumer blaming the OEM for inferior performance, rather than the company that refilled the product. The single-use restriction reduces the number of items that will be unlawfully modified and shoddily refurbished in the aftermarket thereby reducing the likelihood that consumers will purchase inferior and/or faulty products. By reducing the number of inferior or malfunctioning aftermarket products in the stream of commerce, it allows the OEMs to maintain control over the quality of their products and the goodwill associated with their brands. *See Lexmark*, 816 F.3d at 752.

Both OEMs and consumers benefit when the products that enter and remain in the marketplace are safe, reliable and of the quality intended by the OEM and expected by the consumer. Valid use restrictions that do not exhaust patent rights are consistent with current policies and practices in today's marketplace. If these use restrictions were no longer a valid way to retain certain "sticks" in the bundle of patent rights, the incentive for OEMs to offer these programs and the expectations of consumers in purchasing use-restricted items would suffer.

D. Important Policy Considerations of Research and Development Investment and Efficient Economic Development Are Fostered by Allowing Use Restrictions Without the Exhaustion of Rights.

Allowing valid use restrictions recognizes the complexities of patent licensing in today's economy and allows for transactions that acknowledge the importance of rewarding patentees for their investment and development of new technologies. The policy rationale underlying the patent exhaustion doctrine is that rights are exhausted once a "patentee has bargained for, and received, an amount equal to the full value of the goods." *B. Braun Med., Inc. v. Abbot Labs.*, 124 F.3d 1419, 1426 (Fed. Cir. 1997). This rationale does not apply, however, to a conditional sale or license that includes use restrictions. Instead, "it is more reasonable to infer that the parties negotiated a

price that reflects only the value of the 'use' rights conferred by the patentee." *Id.*

The recognition that patentees may reserve certain of their rights within the scope of their patent grant respects the exclusive rights granted by the award of a patent. Overruling *Mallinckrodt* would weaken the rights of patentees in a way that could significantly change the way businesses prioritize and invest in new technology and inventions. *See* Fed. Trade Comm'n, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy*, ch. 1, pp. 1-2 (2003) ("FTC Innovation Report") (recognizing that stable and strong patent policy "encourages prospective inventors to invest time and money in inventions, because a patent's grant of the exclusive right to make, sell and use the invention for a certain period of time can allow inventors to realize returns sufficient to encourage initial investments"). Indeed, "field-of-use, territorial, and other limitations on intellectual property licenses may serve pro-competitive ends by allowing the licensor to exploit its property as efficiently and effectively as possible." U.S. Dep't of Justice and Fed. Trade Comm'n, *Antitrust Guidelines for the Licensing of Intellectual Property*, p. 5 (January 12, 2017).

Patented articles often require millions of dollars in research and development and years to bring to the marketplace. *See* FTC Innovation Report at ch. 3, p. 5 (summarizing testimony from pharmaceutical industry representatives regarding the substantial amount in development costs, often over the course of 10-15 years, to bring a new

drug product to market), at ch. 3, pp. 15-16 (summarizing testimony from biotechnology industry representatives regarding the immense research and development spending and the difficulties in commercializing biotechnology innovation). In light of these costs, OEMs rely on patent rights and carefully structured licensing arrangements to reduce transaction costs, promote new ideas, and mitigate losses in revenue that they may experience due to after-market arbitrage. *See* Osborne, *supra*, at 246 (overruling *Mallinckrodt* "would be a major change in the law and would significantly affect longstanding licensing practices which have served to facilitate the efficient dissemination of patented technologies"); Jared Tong, Comment, *You Pay for What You Get: The Argument for Allowing Parties to Contract Around Patent Exhaustion*, 46 Hous. L. Rev. 1711, 1733-34 (2010) ("If the patent system was created to adequately reward inventors for their inventions and encourage innovation, then surely arbitrage undermines one of the pillars of the patent system.").

Furthermore, use restrictions allow the patentee to exploit its patent rights in different markets or in new and innovative applications without fear of weakening or jeopardizing its patent rights. Austin, *supra*, at 2977 ("Field-of-use restrictions can facilitate the ability of the patentee to exploit its patent rights in different markets, technologies, or applications, with end users benefiting from this wider exploitation."). Indeed, the use of a new product may require access or practice of another patented item, effectively "blocking" improvements or innovations. *Antitrust*

Guidelines for the Licensing of Intellectual Property at p. 5. Allowing limitations on intellectual property licenses, such as restricted-use licenses and sales, can "serve procompetitive ends by allowing the licensor to exploit its property as efficiently and effectively as possible." *Id.*

By allowing rights holders the freedom to protect their market niche while still allowing exploitation of their innovations in other markets or areas, consumers and the public benefit from the reduction of costs and the introduction of novel products, and a competitive and innovative marketplace thrives. *Id.*

The rule in *Mallinckrodt* recognizes that patent licenses and sales of patented products are complex and motivated by important economic, policy, and health and safety concerns. Allowing patentees to consider how these concerns bear on each transaction and to retain certain rights through valid use-restrictions, rather than imposing an "all or nothing" approach to patent rights, is an important aspect of U.S. patent law that has been relied on by patentees and licensees and should be upheld by this Court.

E. Valid Use Restrictions Aid in Beneficial Public Welfare Participation by OEMs, Including Environmental Preservation and Recycling Programs and Anti-Counterfeiting Efforts.

Not only do use restrictions incentivize research and development by rights holders but they also allow patent holders to engage in and develop useful programs that benefit society as a whole. Importantly, use restrictions can aid anti-counterfeiting programs and contribute to successful environmental preservation and recycling programs.

With respect to anti-counterfeiting and gray market goods, when spent items are returned to the OEM after one use, it limits the opportunity for unauthorized reuse or resale and therefore decreases the amount of knockoff items in the stream of commerce. Single-use restrictions provide OEMs with one more tool to combat the ever-growing problems associated with counterfeit and unauthorized goods entering the marketplace.

Furthermore, use and return programs, like the one operated by Lexmark through its single-use cartridge sales, have environmental benefits. When the items are returned to OEMs, they can be disposed of or properly recycled. OEMs are in the best position to track, control and improve programs for the proper disposal or recycling of spent-items and, in fact, ISC members have been operating successful collection and recycling programs for decades. *See* Canon: Consumable Recycling

Programs For Customers, http://downloads.canon.com/nw/about/Recycling-Brochure.pdf (last accessed February 10, 2017) (discussing Canon's cartridge recycling program which was introduced in 1990 and has resulted in the collection of more than 378,000 tons of cartridges around the world); Epson and the Environment: Product Recycling, http://global.epson.com/SR/environment/recycle/ (last accessed February 10, 2017); Brother Environmental Programs, http://www.brother-usa.com/Environment/ (last accessed February 10, 2017); HP Product return & recycling, http://www8.hp.com/us/en/hp-information/environment/product-recycling.html (last accessed February 10, 2017); Samsung S.T.A.R. Program, http://pages.samsung.com/starus/index.jsp (last accessed February 10, 2017); Xerox Green World Alliance, https://www.xerox.com/perl-bin/product.pl?mode=recycling&XOGlang=en_US&referer=xrx (last accessed February 10, 2017).

F. Allowing Valid Use Restrictions Without Exhausting Patent Rights Results in More Choices for Consumers.

Single-use restrictions benefit consumers by allowing manufacturers to sell patented products more economically to consumers who agree that their expended products will not be refurbished or reused. When given the choice of less expensive products, many consumers opt for the single-use restrictions. This gives consumers an "immediate up-front benefit." *Lexmark*, 816 F.3d at 752. In addition, a single-use restriction enables a consumer

to make an eco-friendly choice, while simultaneously paying a lower price for the product. *See* The Nielsen Company, *Green Generation: Millennials Say Sustainability Is a Shopping Priority*, (November 5, 2015) (noting that sustainable products are increasingly in demand).

II. Sales of Patented Articles Made Outside the U.S. Do Not Exhaust Patent Rights.

This court's holding in *Kirtsaeng* does not impact the long-standing exhaustion doctrine that the sale of a patented article that takes place outside the United States does not exhaust the U.S. patent rights in that article. The rule of international patent exhaustion advocated by Impression Products conflicts with existing precedent and the sound reasoning of this Court. Furthermore, important policy considerations warrant upholding the centuries-long held precedent of this Court on which existing market practices are built.

A. *Kirtsaeng* Rested Solely on Statutory Interpretation of the Copyright Act and It Does Not Apply to the Doctrine of Patent Exhaustion.

Kirtsaeng is a copyright case. *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S. Ct. 1351 (2013). The analysis and holding in *Kirtsaeng* that construed a phrase from the Copyright Act -- "lawfully made under this title" -- as having a non-geographical interpretation simply do not apply to patent exhaustion. *See Id.* at 1358. This Court examined

the history and language of the Copyright Act and did "no more [in *Kirtsaeng*] than try to determine what decision Congress has taken" with respect to the exhaustion of rights for works manufactured abroad. *Id.* at 1371. Although Congress may have purposefully delineated international exhaustion in the Copyright Act, it did not do so in the Patent Act.

Instead, patent exhaustion rules are a product of judicially-made common law. *See Quanta*, 533 U.S. at 625 (discussing the longstanding doctrine of patent exhaustion and its roots in early 19th century cases). For over 150 years, a body of jurisprudence has developed to strike a balance between the limited monopoly granted by a patent and the doctrine of exhaustion by "limit[ing] the patent rights that survive the initial authorized sale of a patented item." *See id.* at 621. Part of this balance includes the rule of territorial exhaustion set forth in *Jazz Photo* and reaffirmed by the Federal Circuit below that "United States patent rights are not exhausted by products of foreign provenance. To invoke the protection of the first sale doctrine, the authorized first sale must have occurred under the United States patent." *Jazz Photo*, 264 F.3d at 1105. This territorial exhaustion rule, which originated with this Court's ruling in *Boesch v. Graff* in 1890, has been relied upon for over a century by courts and by rights holders. *See Boesch v. Graff*, 133 U.S. 697, 701-03 (1890).

Accordingly, analyzing and applying the doctrine of patent exhaustion is not a matter of statutory interpretation as it is under the Copyright Act. There is no analogous language in the Patent

Act that can be compared to the language in the Copyright Act that was crucial to the ruling in *Kirtsaeng*. In fact, to the extent this Court were to examine the Patent Act to engage in comparable statutory interpretation to that employed in *Kirtsaeng*, it would find express provisions in favor of a territorial exhaustion rule. Specifically, the Patent Act includes an explicit territorial limitation on acts of infringement and sets forth a separate basis for infringement based upon importation of patented articles from abroad. 35 U.S.C. § 271. This importation right was amended into the Patent Act in 1994 as a result of the U.S.'s ratification of the TRIPS Agreement, which, importantly, expressly disclaimed any effect on the exhaustion doctrine. Uruguay Round Agreements Act, Pub. L. No. 103-465, §§ 532-533 (1994); TRIPS, art. 6, Apr. 15, 1994, Marrakesh Agreement ("For the purpose of dispute settlement under this Agreement, subject to the provision of Articles 3 and 4, nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights."). These provisions are consistent with the doctrine of territorial patent exhaustion. Patent laws "do not, and were not intended to, operate beyond the limits of the United States" and the territorial exhaustion rule is consistent with that axiom. *Brown v. Duchesne*, 60 U.S. 183, 195 (1857).

Instead, a long line of binding precedent defines the doctrine of patent exhaustion and informs its application to the issues in *Jazz Photo* and before the Court today. These patent cases are and should remain good law. Indeed, this Court recently emphasized the importance of *stare decisis*

to ensure certainty, consistency, and stability in the administration of justice - goals that would not be served by reading a ruling on patent exhaustion into *Kirtsaeng*. *See Kimble v. Marvel Entm't, LLC*, 135 S. Ct. 2401, 2409 (2015). Consistent with the principles set forth in *Kimble*, this Court's long-standing precedent of *Boesch v. Graff* should be preserved and respected. The copyright ruling in *Kirtsaeng* does not and should not overrule the doctrine of territorial patent exhaustion and this Court should affirm the well-reasoned and thorough decision of the Federal Circuit.

B. Patents and Copyrights are Different and Should be Treated Differently With Respect to Exhaustion of Rights.

The goals and functions of patent law and copyright law are distinct. These distinctions have long been recognized by this Court, having first examined the issue of exhaustion and first sale in the copyright context. *Bobbs-Merrill Co. v. Straus*, 210 U.S. 339, 346 (1908) ("[t]here are such wide differences between the right of multiplying and vending copies of a production protected by the copyright statute and the rights secured to an inventor under the patent statutes"). In light of these differences, copyright cases are not and should not be controlling on substantive issues related to patent law. *Id.*; *LifeScan Scotland, Ltd. v. Shasta Techs., LLC*, 734 F.3d 1361, 1376 (Fed. Cir. 2013) (noting that copyright cases may reinforce conclusions of patent law, but are not controlling on such matters).

Because patent rights and copyrights are very different, so too are the policy reasons for either strengthening these rights or limiting them through doctrines like exhaustion. Simply put, copyright protection is easy to get, lasts for a very long time, and requires no formal examination or notice to the public before it takes effect. Specifically, copyright applies automatically upon creation of a work, requires only minimal degrees of creativity and originality, and lasts for up to 70 years beyond the death of the author or 120 years from creation. *See* 17 U.S.C. § 102 (subject matter); 17 U.S.C. § 302 (duration).

Patents are very different. Patent protection is reserved for novel and useful inventions which must undergo stringent examination and review before patent rights are granted. 35 U.S.C. §§ 101-103 (patentable subject matter); 35 U.S.C. §§ 131-135 (examination). As a result, patented articles generally require more research and investment in up-front development costs, as well as more time and money to obtain patent protection than copyrighted works. *See Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 480 (1974). Furthermore, the duration of patent rights (20 years) is much shorter than copyrights, which means that, as compared to authors of copyrighted works, patentees enjoy a relatively short period of exclusivity, especially considering the time and investment required to secure a patent. *See* 35 U.S.C. § 154 (patent duration). Finally, the types of creations protected under each regime are very different; copyright law traditionally protects artistic expressions, while patent law protects useful inventions.

These significant differences between copyrights and patents warrant different treatment by the courts and the legislature. For example, the justifications for enhancing the protections granted to a life-saving patented drug or a break-through technology simply do not apply to a novel, text book or photograph that may enjoy the benefits of copyright protection. While both may be important, they serve very different roles in society. Because of these differences, and the different policy considerations discussed below, this Court should uphold the Federal Circuit's rule of domestic exhaustion.

C. Important Policy Considerations Favor the Long-Standing Rule That Sales Abroad Do Not Give Rise to Patent Exhaustion.

Important policy considerations support the domestic exhaustion rule that was affirmed by the Federal Circuit and that should remain unchanged by *Kirtsaeng*. Indeed, the relative rights of patentees, competitors and the consuming public are best served by the rule of territorial patent exhaustion. Turning this long-standing rule on its head and instituting a rule of international exhaustion would change the way U.S. patentees do business in today's global economy and would change the U.S. marketplace for the worse – for both companies and consumers. The current rule of territorial exhaustion allows OEMs to participate in global trade and yet still protect their significant investment in patented items and inventions and their brand reputation in the U.S. market.

1. The Territorial Rule of Exhaustion Properly Incentivizes Innovation in the U.S. and Supports Economic Development.

The policy goal of incentivizing and rewarding innovation is central to U.S. patent laws. *Kewanee*, 416 U.S. at 480 ("The patent laws promote this progress by offering a right of exclusion for a limited period as an incentive to inventors to risk the often enormous costs in terms of time, research, and development."). Intellectual property rights allow patentees to obtain a return on their investment in new inventions which, in turn, incentivizes further innovation and dedication of resources to research and development. *See* Shubha Ghosh, *Pills, Patents, and Power: State Creation of Gray Markets as a Limit on Patent Rights*, 14 Fla. J. Int'l L. 217, 224 (2002) (noting that the large fixed costs of developing patented products will not be expended unless there is a guarantee of reasonable return from the investment).

An international exhaustion rule would lead to rewards and incentives for the wrong parties – the unauthorized importers and arbitragers who take advantage of lower prices overseas to make a profit and to infringe the rights of U.S. patentees. Even if U.S. consumers would benefit from lower prices from overturning the territorial exhaustion rule, the proper metric for the overall welfare must consider that U.S. citizens are both consumers and patentees. Daniel J. Hemel and Lisa Larrimore Ouellette, *Trade and Tradeoffs: The Case of International Patent Exhaustion*, Colum. L.

Rev. Online, Vol. 116, Sec. II, para. 7 (2016), *available at* http://columbialawreview.org/content/trade-and-tradeoffs-the-case-of-international-patent-exhaustion/. The "enormous costs in terms of time, research, and development" borne by the patentee are eroded by gray market arbitragers and unauthorized importers without a corresponding benefit to the patentee and without recourse under U.S. patent law. If gray market goods are offered at lower prices than legitimate goods and OEMs are priced out of their own market, they will be less likely to invest in new technology because they will be unable to recoup their investment.

By maintaining the territorial rule advanced by the Federal Circuit, U.S. patent law serves its goal of promoting innovation and development by patentees, who expend substantial resources and time on research and development to bring new inventions to market. Fostering these goals furthers growth of the U.S. economy and benefits the consuming public. *See Kewanee*, 416 U.S. at 480 (incentivizing innovation through patent protection leads to "a positive effect on society through the introduction of new products and processes of manufacture into the economy, and the emanations by way of increased employment and better lives for our citizens"); David R. Sugden, *Gray Markets: Prevention Detection and Litigation*, at 51, Oxford University Press (2009) ("[e]nsuring that individuals and companies collect their R&D costs ultimately benefits consumers" whose lives are improved by innovative products).

2. Upholding the Federal Circuit Allows for Beneficial Global Price Differentiation and Market Segmentation.

An international patent exhaustion doctrine assumes that the sale of a product abroad will yield the desired "single reward" to the patentee. However, this approach ignores global price differentiation and market differences that are beneficial to worldwide consumers and necessary for patentees' participation in a global market. Effective global price differentiation requires effective controls on gray markets, including allowing patentees to enforce their U.S. patent rights against unauthorized imports under the rule of *Jazz Photo*. *See* Jeffery Atik and Hans Henrik Lidgard, *Embracing Price Discrimination: TRIPS and the Suppression of Parallel Trade in Pharmaceuticals*, 27 U. Pa. J. Int'l Econ. L. 1043, 1058 (2006).

Importantly, the level and nature of patent protection in foreign countries may contribute to price differentials in different global markets. In the United States, inventors can rely on a well-developed body of patent law and effective enforcement of their patent rights to protect their considerable investments in developing innovative products. In many international markets, by contrast, it is difficult or impossible to register patents and enforce patents rights. *See Microsoft Corp. v. AT&T Corp.*, 550 U.S. 437, 455 (2007) ("foreign law may embody different policy judgments about the relative rights of inventors, competitors, and the public in patented inventions") (internal

quotations omitted). In foreign markets with ineffective or insufficient patent protection, companies that make innovative products must lower their prices to compete with other companies that produce low cost, cloned versions of the same product without the considerable costs of development. *See* Michele L. Vockrodt, *Patent Exhaustion and Foreign First Sales: An Analysis and Application of the* Jazz Photo *Decision*, 33 AIPLA Q.J. 189, 199 (2005).

Price differentiation can also be driven by a number of different economic factors, including fluctuations in currency exchange rates, tax differences, different consumer preferences or abilities to pay, and differing distribution channels. Alvin Galstian, *Protecting Against the Gray Market in the New Economy*, 22 Loy. L.A. Int'l & Comp. L. Rev. 507, 508 (2000); Paul Lansing & Joseph Gabriella, *Clarifying Gray Market Gray Areas*, 31 Am. Bus. L.J. 313, 314 (1993). Various governments also subsidize the cost of certain goods, such as medicine and laptops for children. Hemel and Ouellette, *supra*, at Sec. II, para. 1.

Furthermore, there may be public welfare reasons for encouraging market segmentation and price differentiation. Specifically, patentees may offer patented articles at a low price in one market to encourage development and growth or to improve health and safety in countries stricken by disease or misfortune. Market segmentation allows OEMs to participate and compete in a global economy by structuring their pricing in ways that take into consideration all of the factors associated with doing

business in that foreign market, including currency fluctuation, patent protection, taxes, distribution channels and public welfare concerns.

Moreover, this geographic price discrimination provides for certain economic efficiencies, as compared with a single worldwide price, which would likely result in consumers in higher income economies enjoying lower prices at the expense of increased prices for lower income markets— thereby causing exclusion of the product from some of the most economically vulnerable markets. Hemel and Ouellette, *supra*, at Sec. II (noting that "while the net winners and losers from a U.S. international exhaustion rule are somewhat ambiguous, it seems clear that consumers in low-income countries do not come out ahead"). Without the territorial rule for patent exhaustion, patentees would need to select a worldwide price since otherwise importation of low-income market goods to middle and high income markets would cause a convergence of global prices at the lowest available price point. *Id.* In short, reversing the Federal Circuit's holding in *Lexmark* effectively would result in a mass redistribution of wealth from less developed markets to higher income markets. *Id.*

3. A Rule of Territorial Exhaustion Allows Patentees to Meet the Needs of Underdeveloped Markets.

By upholding the rule of *Jazz Photo*, underdeveloped markets will continue to benefit in two important ways: (1) products intended for the

lower-priced market will stay in the lower-priced market and be available for those consumers to purchase; and (2) OEMs will be encouraged to continue offering lower-priced goods in less-developed countries because they will be able to recoup investments and prevent a rampant gray market. Territorial exhaustion provides patentees with a way to combat the importation of goods priced and intended for a foreign market so that they can continue to sell products at lower prices in these needy countries without the supply being diverted into the United States.

Many patented products, including life-saving drugs, medical devices and life-changing technology are sold at lower prices in poorer countries to the benefit of people in those countries who could not otherwise afford them. Left unchecked, however, the gray market takes lower-cost articles from less-developed countries and diverts them for resale in higher priced markets. Atik & Lidgard, *supra*, at 1060. When products are diverted from lower-priced markets to be sold in the U.S., those who need the low prices to afford a patented drug or an innovative technology have no opportunity to buy it before it is swept back into the United States gray market. Simply put, gray markets and parallel imports transfer benefits from consumers in developing countries to importers. *See* Hillary A. Kremen, *Caveat Venditor: International Application of the First Sale Doctrine*, 23 Syracuse J. Int'l L. & Com. 161, 163 (1997).

Furthermore, OEMs can afford to offer lower prices in less-developed markets only because higher

prices that OEMs receive in wealthier markets can offset the significant costs of research and development, marketing, and production so that the product remains profitable. Companies that sell patented products in underdeveloped countries need to be able to amortize their investment through sales at higher prices in developed markets where the higher cost can be borne by wealthier consumers. *See* Atik and Lidgar, *supra*, at 1047-48 ("[t]he willingness of the pharmaceutical industry to distribute drugs at low cost...depends on its confidence that these drugs will not filter back into high priced markets"). Without the ability to price differentiate their products for international markets, OEMs are impeded from competing internationally and may be discouraged from entering developing markets with accessible prices. Vockrodt, *Patent Exhaustion and Foreign First Sales*, 33 AIPLA Q.J. at 200. Making patented inventions available and accessible in less-developed countries, while still allowing patentees to bring these inventions to market and stay profitable, is an important policy justification that supports the *Jazz Photo* rule of territorial exhaustion.

These policy considerations that support different prices in different markets for patented articles are different than those considered (and rejected) by the Supreme Court in the copyright context. *See Kirtsaeng*, 133 S. Ct. at 1371. As discussed above, the nature of articles protected by patent law (pharmaceuticals, new technologies, medical devices) are very different than the types of works protected by copyright law. Specifically, patented items are novel and useful inventions that

can benefit societal health and welfare. Because of this, the ability to engage in price differentiation and global segmentation for patented articles is justified by different policy goals, including improving public welfare by encouraging and protecting innovation.

Indeed, life-saving or life-changing inventions can make a huge impact on the economy and public welfare. However, these inventions also require substantial investment to bring to market and are priced so that those costs can be recovered. By keeping in place a rule of patent law that allows and encourages market segmentation, patentees can lower the price in less-developed markets so that needy consumers there have access to these new inventions and patentees can still recover the return on their investment by charging higher prices in wealthier markets. Such beneficial new inventions might not be available to consumers in a less-developed market without price differentiation or market segmentation. The policy justifications for supporting increased accessibility and further development of patented articles for the benefit of the public are stronger in the context of patented new technologies than in the context of copyrighted textbooks.

4. A Rule of Territorial Exhaustion Aids in Combating Unauthorized Gray Markets and Counterfeiting while Supporting Consumer Protection.

Intellectual property rights, particularly patent rights, are important tools in OEMs' ongoing battle against counterfeiting and unauthorized

parallel imports. OEMs must be able to continue to rely upon their patent rights as an integral tool in preventing unauthorized gray market goods from entering the U.S. market. Under the existing rule of territorial exhaustion, the gray market is checked by rights of patent owners. *See* Shubba Gosh, *Pills, Patents, and Power; State Creation of Gray Markets As a Limited on Patent Rights*, 14 Fla. J. Int'l L. 217, 222 (2002) ("Gray markets in the United States are extremely rare when patent law comes into play"). If this rule is overruled, the gray market for goods is likely to increase because unauthorized importers of parallel goods will no longer face the risk of a patent infringement suit. *Id.* This increased and uncontrolled gray market will lead to negative consequences contrary to public policy, including (1) harm to the consuming public; (2) damage to the rights and interest of OEMs; and (3) threats to the health of the economy and the safety of the public. *See* Sugden, *supra*, at 5-6 (discussing the "host of significant risks" associated with gray market goods).

Consumers of unauthorized gray market goods will suffer because gray market goods are often different from authorized imports or domestic goods in material ways. *See* Alvin G. Galstain, Comment, *Protecting Against the Gray Market in the New Economy*, 22 Loy. L.A. Int'l & Comp. L. 507, 510 (2000). For example, foreign goods may be altered to comply with different health and safety codes for varying markets, or they may be designed or marketed differently to account for regional or cultural differences or languages. *Id.* While consumers may initially be attracted by the lower

prices of gray market goods, that attraction usually turns to disappointment -- or worse -- when the product fails to function properly, fails to meet local health or safety requirements or when consumers are unable to have the unauthorized product serviced or repaired by the OEM or an authorized reseller. *Id.*; KPMG LLP, *Effective Channel Management is Critical in Combating the Gray Market and Increasing Technology Companies' Bottom Line; KPMG Gray Market Study Update*, 3 (2008) ("*Gray Market Study*"), *available at* www.agmaglobal.org/cms/uploads/whitePapers/7-10-08KPMGWhitePaperGrayMarketStudy.pdf (purchasers of gray market technology products risk data loss and business interruption).

Moreover, consumers may be harmed by the importation of unauthorized gray market goods that unbundle the sale of the physical product from the customer services associated with the same that customers expect. Often the retail price of goods, particularly those sold by OEMs, reflects not only the cost to manufacture the physical good but also the associated support services the manufacturer provides, such as technical and consumer support as well as warranty protection. These services protect consumers. When third-parties import gray market goods without authorization, these support services are often voided in the unauthorized territory. *See* Mark Weber Tobias, *Buying Gray Market Cameras: What You Need to Know*, Forbes, October 29, 2014 http://www.forbes.com/sites/marcwebertobias/2014/10/29/buying-gray-market-cameras-what-you-need-to-know/#76517b303c99 (noting that customers may be

surprised to learn that their "discounted" grey market goods often are not covered by a warranty).

Accordingly, consumers may decide to purchase a seemingly "authentic" gray market good believing they will be able to benefit from the customer service and warranties of the manufacturer but are unaware that the cheaper price of the unauthorized import and gray market actually unbundles the sale of the product from the services that consumers expect. This harms not only the manufacturer whose reputation may be damaged by a disappointed consumer who finds that warranties or support are not available, but also consumers who had no reason to believe that their purchase of a good imported from abroad meant they would be cut off from the consumer services that the manufacturer had built into the pricing model for the U.S. product. In addition, this allows third-parties who have contributed nothing to innovation to "free ride" from the manufacturer's hard earned goodwill by exploiting consumer trust in the manufacturer's reputation for their own profit.

Gray markets also harm OEMs. When OEMs are cut out of the distribution channel through the sale and re-importation of foreign goods, quality control over these goods is virtually impossible. *Gray Market Study* at 7 ("OEMs generally have no visibility into unauthorized sales and cannot ensure that products sold are new, authentic, undamaged goods and are properly installed and supported."). This loss of control over quality and safety issues, as well as the disappointed consumers described above,

inevitably leads to erosion of the OEMs' goodwill. Galstain, *supra*, 510-11.

Furthermore, gray markets unfairly drive down the prices OEMs and authorized resellers can charge to stay competitive in their own market. *See* KPMG, *Gray Market Study* at 9 (reporting poll results that say many gray market prices are more than 25 percent lower than average authorized distribution channel prices). With an uncontrolled gray market, OEMs and authorized resellers often must price their U.S. products lower to compete with the unauthorized foreign goods sold in the U.S. at low prices by gray market dealers. Sugden, *supra*, at 41. Because unauthorized importers do not have research and development costs or the expenses of marketing, customer support, and product quality control that OEMs have (and often require of their authorized resellers), the gray market dealers can price their imported products much lower and still turn a profit. This allows gray market dealers to get a "free ride" at the expense of the OEMs' reputation and goodwill and in competition with OEMs and authorized resellers.

Perhaps the most dangerous result of an unchecked gray market is a corresponding increase in counterfeit or "black market" goods and a decrease in the effectiveness of anti-counterfeiting efforts and laws. Sugden, *supra*, at 6 ("[o]ne of the most significant consequences of an unchecked gray market is the commingling of gray and black market products"). The risks to public health and safety posed by the counterfeit market are well-documented and pervasive. *See* United Nations Office on

Drug and Crime, *Counterfeit Products* (2010), *available at* https://www.unodc.org/documents/data-and-analysis/tocta/8.Counterfeit_products.pdf (reporting on the link between counterfeiting and serious offenses such as drug trafficking, smuggling, money laundering, tax evasion, corruption). Gray market goods are often mixed with and sold through the same channel as black market goods, making it difficult to distinguish the two. Sugden, *supra*, at 53. As a result, it is easier for counterfeiters to import illegal goods into the United States and more difficult for OEMs and law enforcement to determine whether goods coming into or being offered for sale in the U.S. are gray market goods or counterfeits. *See* Addie T. Katz, *The Merging of Black and Gray: International Copyright Infringement in the Post-Kirtsaeng Era*, 43 Hofstra L. Rev. 291, 293 (2014); Sugden, *supra*, at 52; *see also*, *Zino Davidoff S.A. v. CVS Corp.*, 571 F.3d 238 (2d Cir. 2009) (prominent retailer selling both gray market and counterfeit versions).

If the existing rule of territorial exhaustion is overturned, the U.S. market for gray and counterfeit goods will increase, with serious repercussions to health, safety and public welfare. Good public policy requires a legal framework that prevents unauthorized importation of patented articles and supports efforts to keep potentially dangerous knockoffs and unauthorized foreign imports from entering the market.

CONCLUSION

Both rights holders and consumers benefit from a rule of patent exhaustion that (1) allows for valid use-restrictions and (2) respects the territorial boundaries of U.S. patent law. The ISC urges this Court to affirm the decision below and to maintain the stable and long-standing practices of patent holders and downstream users that contribute to a vibrant and healthy U.S. economy.

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